Friday Morning Coffee

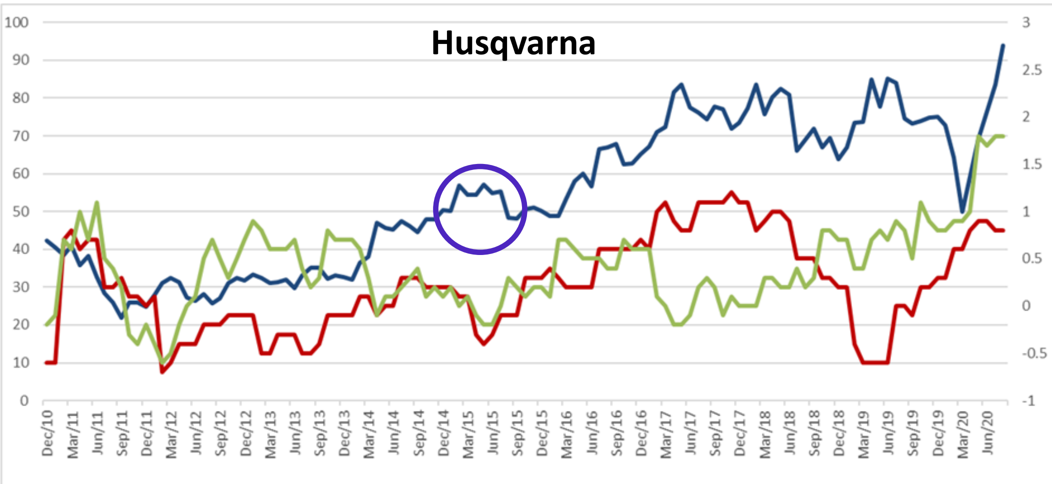
European Capital Partners

Nr. 119 — While some are throwing the towel on value …

We hear that several large asset managers are throwing the towel on value investing. One example is Nordea merging its Nordea European Value Fund into the Nordea European Stars Equity Fund. I have been co-manager of Nordea European Value Fund between 2002 and 2014 so I can state with a certain level of confidence I have some understanding of the underlying investment strategy and process of this Fund. I also understand the receiving fund targets large-cap companies that appear to offer superior growth prospects and investment characteristics and focusses on ESG. My personal conclusion is the 2 strategies are as different as they can be. Investors should therefore not expect to see similar investment results over the long run, as the initial strategy of over more than 20 years, is a strategy selecting companies with undervalued earning power.

It is frustrating most value strategies have shown mediocre results over the last years. **Reasons for the underperformance lie in ultraloose central banks policies with low interest rates, technological revolution eating into traditional moats and a "winner takes it all environment" for some Big Tech names**. Nevertheless, we would caution investors to bet the farm on growth and momentum at this moment in time, where the pandemic has exasperated the existing trend of relative outperformance of growth and momentum stocks.

For a contrarian investor the more unloved, neglected, and disliked value stocks are, the more investment opportunities, and the higher the return potential value strategies have. **As many investors are leaving the field, the few ones having the staying power are indeed finding a sea of investment opportunities. We believe value investing is still misunderstood and being stigmatized as investing in "dirty" and cyclical industries or in financials in terminal decline**. When I look at the value portfolio, we run at ECP, this is not the case. For example, one position in the portfolio is the Swedish Husqvarna, the world's largest producer of chainsaws, lawn movers, robotic lawn movers and other garden equipment such as trimmers and leaf blowers, as well as one of the world's largest producers of garden tractors. A graphical presentation of the company in our proprietary quality – value framework shows why in 2015 we started investing in the company, at a moment we detected important improvements in the quality of the business.



Source: ECP

The following note gives the opinion of the Investment team at the time of the publication. Please refer to important notice at the end of the document.

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Management has delivered: Husqvarna has almost doubled operating margins from 5% to 10% 2013-2017. This has been driven by strong revenue growth and cost efficiency in the three growth divisions: Husqvarna, Gardena, and Construction. Husqvarna is a margin improvement story as the company exit from low margin businesses and keep improving the product mix in the core growth segments. Incremental margin improvement from 2018 onwards come from exiting 30% of the US mass retail business (Consumer Brands). Husqvarna improves an already strong history of generating business returns and cash flows far above what is needed to run the business. It took some patience for us as investors, but our staying power is finally being rewarded.

The company came out this week with the third positive trading update in a row due to a prolonged lawn and garden season supported by the Covid-19 stay-at-home trend related and positive weather conditions. Once again product mix was said to be 'favourable', with strong growth in robotic lawn in high margin mowers and watering.

This example illustrates that investing is not all about growth and momentum. Long term investors can make money by leaving the consensus routes and investment themes while keeping a close eye on the valuations they are willing to pay. While some are throwing the towel on value, the remaining active value investors may well start outperforming by staying invested and selecting businesses with undervalued earning power.

I wish you a nice weekend,

Léon Kirch, CFA
Partner & Chief Investment Officer
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